BY LOUGHLIN F. MC HUGH

Business Financing in 1960

Fixed Capital Demands Remain High—Working Capital Needs Shift—Supply Conditions Eased

BUSINESS corporations generally maintained their end of 1959 financial position in the first half of 1960. Profits have moved in an irregular fashion over the past year and since the first quarter have tended lower as profit margins came under pressure. With dividends maintained, earnings retained in business have been lowered. Depreciation set-asides reached a new high, for the most part reflecting the expanded capital base, and the combined gross internal flow of equity funds—retained earnings plus depreciation charges—was close to the earlier top but with the contribution of the two major sources differing.

The volume of long-term capital raised in external markets by business firms has been fairly steady in the last year and a half, though reduced from the heavy financing carried on during the previous business upswing in the 1956–57 period. (See chart.)

The combined flow of internal and external long-term capital financing in the first half was at a seasonally adjusted annual rate of $40 billion for all non-financial corporations, about the same as in 1957 and 1959, and roughly $3 billion more than in the 1958 recession period.

The current requirements for such funds for fixed capital expenditures are substantially higher than in 1959, and plans for such investment in the second half of this year involved a further increase over the first-half results.

The cushion of corporate liquid funds was an important influence in financing the 1959–60 business advance, and in the 12-month period ended last June corporate managers drew down their liquid asset holdings to supplement the record volume of long-term financing.

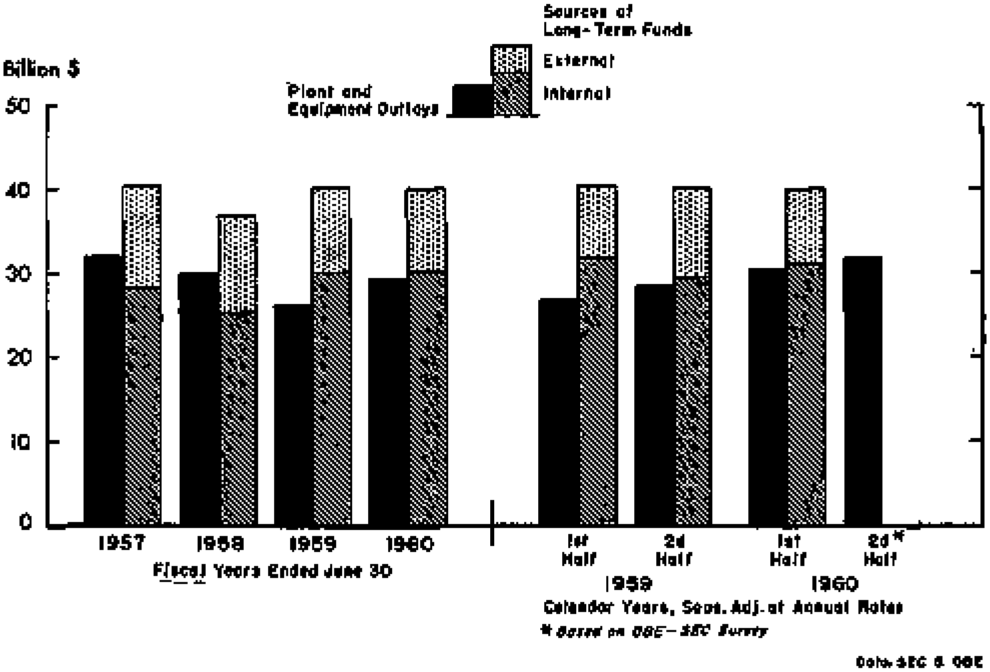
Working capital higher

Capital requirements other than for plant and equipment and liquid asset ownership—basically for building inventories and financing customers—have been exceptionally heavy in the past two years of cyclical advance, with the expansion pressure sustained at a relatively even pace after allowing for the usual seasonal influences and such special factors as the pre-steel and post-strike build-ups and the strike-related tapering of demands. In the year ended last June, nonfinancial corporations added close to $20 billion in working capital assets other than liquid resources. This was $2 billion more than in the preceding year and in the year ended June 1957.

The most recent expansion in such working capital was exceeded only in the 12-month period through June of 1956, when the addition came close to $25 billion. The greater inventory build-up in that earlier period largely accounts for the difference. The increase in terms of the book values of over $8 billion during the year ended June 1956 was about double the inventory accumulation observed in the last 12-month period.

All in all, the recent financial picture for corporate business has conformed fairly closely to that which is typically experienced in periods of cyclical advance: sharp increases in fixed and working capital assets and the concomitant pressures for both long- and short-term funds; expansion of internally generated funds and yet substantial need for external financing; the net

Corporate Long-Term Financing and Outlays on Plant and Equipment



U. S. Department of Commerce, Office of Business Economics

Data: SEC & OBE

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result of improved liquidity as cash assets were accumulated, and later, the using up of such resources to meet still expanding needs as internal financing levels off.

During this period, the external financing supply conditions traced a similar cyclical conformity. During the upswing when capital demands threatened to become excessive, the monetary authorities moved to restrain the expansion of bank credit and borrowing costs rose to postwar highs.

As demands leveled after last winter's upsurge, credit conditions eased considerably and this easing was fostered by the central bank actions utilizing all major tools available—reduced discount rates to member banks, open market operations to provide extra reserves, and most recently, a lowering of reserve requirements. The impact of these activities is strikingly apparent in the free reserve position of member banks which currently shows an improvement of close to $1 billion as compared with a year ago. (See chart.)

The current picture

Recent developments have accentuated the usual problems encountered by business firms. The reduction in profit margins, with dividends maintained, has had its impact on retained earnings. Funds set aside from depreciation allowances are continuing higher but it is doubtful that they have made up for the drop in earnings from the peak. Meanwhile fixed capital outlays of business are scheduled to be higher. Thus, there is a *substantially lessened* volume of funds available for working capital purposes from internal sources.

At the same time, reduced expansion on current account, which is already evident in the inventory picture, diminishes the need for additional funds to increase the working capital of corporations. This is *mirrored* in the area of short-term financing by reduced bank borrowing for business purposes.

Costs of borrowing reduced

In the second and third quarters signs of such tapered demand have been apparent. Combined with actions of monetary authorities, this has meant that the cost of borrowing has eased off from earlier highs. So far this has been most apparent in the short-term area, with banks reducing their prime rate in August.

Fixed charges on business income—as reflected in interest payments—have also risen to new highs, as a result of the expansion of debt and higher average interest rates being paid on outstanding debt. At the recently experienced profits volume, such charges represent the highest relative share of postwar corporate earnings, though they are still well below those for the comparable prewar period of prosperity in the late twenties.

Average costs of outside equity financing have moved higher recently as a result of the decline in market prices of equity issues. However, as of mid-1960, such costs were still low by any postwar experience prior to 1959. Stock prices had risen sharply since the late 1940's. While dividends and earnings also moved upward over this interval, stock yields in 1959, absolutely and in relation to borrowing costs were the lowest for the postwar period.

Liquidity patterns

In general, corporate business has maintained a relatively liquid position through mid-1960. The build-up of cash and U.S. securities in the 1958–59 period and the modest liquidation more recently left business firms in the aggregate with such resources at a level comparable with the needs indicated by the higher volume of business sales and activity. There has, however, been some shifting in these resources.

Table 1.—Corporate Financing in Three Postwar Cycles

[Billions of dollars]

	Year ended June 30				
	1956	1957	1958	1959	1960
Most recent cycle					
Sources					
Long-term	37.8	40.3	30.9	40.0	39.9
Short-term	12.7	6.6	−7.1	11.0	8.0
Uses					
Plant and equipment	30.9	31.0	30.1	26.2	30.5
Other assets	23.1	17.2	−.3	25.4	18.4
	Year ended June 30				
	1952	1953	1954	1955	1956
1953–54 cycle					
Sources					
Long-term	24.8	28.1	25.8	38.3	37.3
Short-term	3.1	6.6	−6.2	6.8	12.7
Uses					
Plant and equipment	22.5	22.8	23.5	22.4	26.0
Other assets	7.4	11.6	−4.4	20.6	23.1
	Calendar years				
	1947	1948	1949	1950	1951
1948–49 cycle					
Sources					
Long-term	21.7	26.9	19.2	26.0	20.8
Short-term	9.6	3.1	−3.7	19.2	12.8
Uses					
Plant and equipment	17.0	18.8	16.3	16.9	21.0
Other assets	14.2	10.2	−.8	27.3	18.0

Source: U.S. Department of Commerce, Office of Business Economics, based on Securities and Exchange Commission and other financial data.

Table 2.—Corporate Receivables and Payables

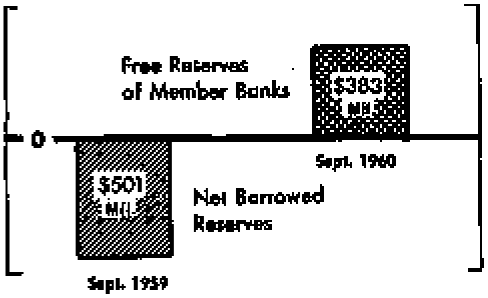
[Billions of dollars]

	Receivables			Payables, trade	Net trade receivables
	Total	Consumer	Trade		
	Change During Calendar Year				
1947	7.8	1.4	6.3	4.6	1.7
1948	4.1	1.3	2.8	1.3	1.5
1949	.6	1.5	−.9	−.3	−.6
1950	13.8	1.8	12.0	8.8	3.2
1951	4.7	.8	3.9	2.7	1.2
	Change During Year Ended June 30				
1952	3.4	1.4	2.0	−.9	2.9
1953	6.8	2.2	4.6	4.7	−.2
1954	−1.4	.6	−2.0	−2.1	.1
1955	8.1	2.2	5.9	2.7	3.2
1956	10.4	2.4	8.0	6.4	1.6
1957	7.7	1.0	6.7	4.6	2.1
1958	.6	0	.4	−2.2	2.7
1959	10.0	1.3	8.7	5.7	3.0
1960	7.9	2.6	5.3	3.3	2.0

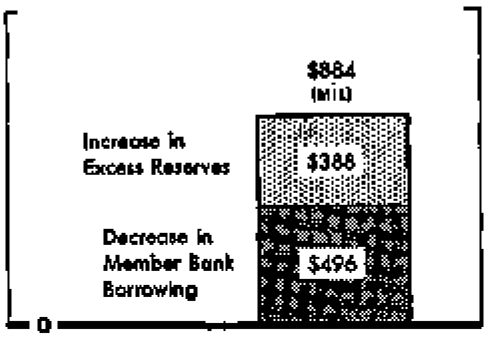
Source: Securities and Exchange Commission.

COMMERCIAL BANKING PICTURE

Considerably Eased



Changes in Free Reserves Sept. 1959-60



Data: FRB

U. S. Department of Commerce, Office of Business Economics 60-10-12

The manufacturing group, which has been in the forefront of recent dynamic aspects of business change, saw its liquidity position reduced through mid-1958. There was some improvement in the succeeding 12-month period but this has subsequently been reversed, and this meant the using of liquid funds in the past year. The recent movement has left manufacturers as a group in about the same relative liquid asset-sales position as they were in mid-1957, which represented the low for the postwar period.

On the other hand, non-manufacturing concerns—more particularly those dealing in distribution channels—have maintained a considerable portion of the improved liquidity which was sustained through mid-1959.

Sources and Uses of Corporate Funds

Up-to-date regularly published figures for corporate sources and uses of capital funds are shown in tables 3 and 4 through June 30 of this year. Since these figures are not adjusted in detail for seasonal influences, they may perhaps be most usefully compared taking 12-month intervals ended June 30. Such a combination for recent years is about the closest approximation available to cyclical recoveries and recessions. In this context several interesting features stand out and may be briefly reviewed.

Long-term financing

In the last 2 years, more than 50 percent of the $40 billion annual totals of long-term financing has been provided internally through the investment of depreciation allowances. These funds have steadily expanded in absolute and relative terms throughout the postwar period. However, the annual new increment is currently close to $1 billion compared with $2 billion of additional new funds obtained in the mid-1950's. This reduced amount of increment, despite record or near-record additions to gross capital base, reflects the changing pattern of depreciation charges against current income. In that earlier period depreciation allowances were being swelled by the fast writeoffs permitted on defense-related facilities. Beginning in 1955 the cutoff in the Korean 5-year amortization program brought a tapering in funds from this source and at the current time virtually all of the facilities on which such amortization was granted have been fully amortized. However, since 1955, a modified form of accelerated amortization on new facilities permitted to business firms generally has served to raise depreciation charges, but in the last several years the impact of this change has been offset by the reduced availability of funds under the Korean program.

Other sources of long-term financing—retained earnings and securities market sales—have been sizable, but generally speaking, more sensitive to fluctuations in general business. Retained earnings in the past 2 years have averaged close to $8½ billion a year, up moderately from the 1958 recession low of $6 billion but well below earlier highs of $13 billion in 1950 and $11 billion in 1955–56.

Market financing steady

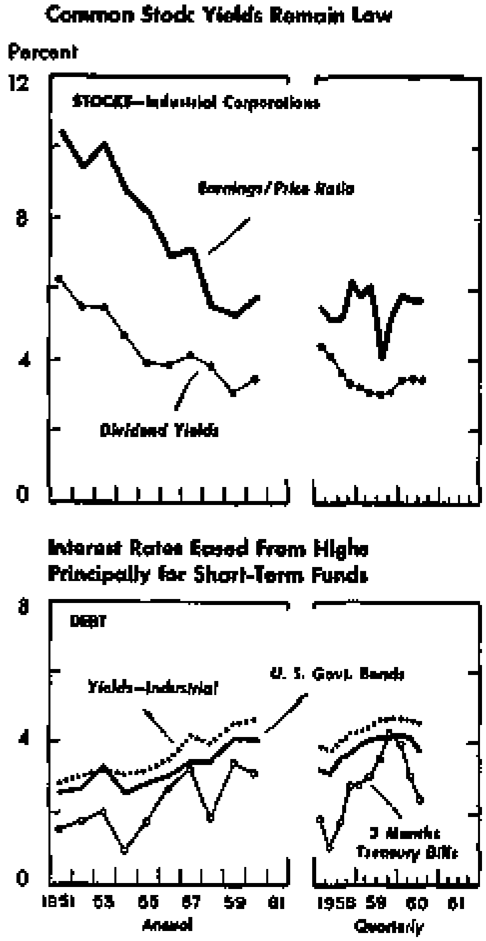
The net inflow of long-term corporate funds raised in the capital markets and from other institutional sources has held steady in the last 2 years at about $10 billion annually. While these sales compared favorably with any experience prior to 1956, they were down from the total raised in 1956–57 and were less than in the 1958 recession period when many financing plans earlier arranged were carried through.

In the most recent period, financial concerns—largely investment and finance companies—have expanded their recourse to long-term capital markets. Mutual funds have shown an especially strong growth trend. These firms do not, generally speaking, provide a net new inflow of capital to the universe of corporations of which they are a part, since the proceeds of their security sales are typically channeled in purchases of existing corporate issues. However, by providing a medium for investment by the smaller scale investors, the activity of such firms imparts a fluidity to the saving-investment process which aids in the financing of business capital requirements.

Manufacturers reduce demands

Among other major users of the long-term securities markets, recent tendencies have been in the direction of reduced net sales. Manufacturers in particular cut back their net new issues in 1960. Typically these concerns expand their use of such financing in the late recovery period but cut back sharply when capital expenditures are reduced in the recession. They also find little need for external long-term financing in the early recovery period when internally generated funds are rising. The relatively light demand of manufacturers as represented by net new issues in the past year contrasts rather markedly with expanding capital demands at comparable stages of the upswings in 1951 and 1956–57.

FINANCING COSTS



Note.—1960 is 9 months average; 3rd. of 1960 is estimated

Data: Moody's

U. S. Department of Commerce, Office of Business Economics 60-10-10

Net proceeds to corporate business from the sale of stock issues do not show any special cyclical pattern. Net new stock issues have varied in the $3 to $4 billion range in the last 4 years, compared with a range of $2–3 billion in the preceding 4-year period and an average volume of $1½ billion earlier in the postwar period. Much of the underlying growth tendency over this interval has reflected the growing importance of mutual funds whose issues do not represent a net addition to the inflow of corporate equity funds.

Swings in debt financing

A lagged response to cyclical conditions is apparent in long-term debt financing and here, as already indicated for total security sales, the fluctuating element is contributed by the shifting demand of manufacturers.

Working capital shifts

By far the most volatile aspect of corporate financing is associated with changed working capital requirements. Note in table 1 that in the four upswings, additions to current assets have been quite sharp and in the two most recent instances—1956–57 and 1959–60—especially large. In contrast, during recession periods, expansion of current assets is halted.

These swings are, of course, mirrored in the changing pattern of short-term debt. It will be noted, however, that in the upswing, the expansion of current assets substantially exceeds the growth of short-term liabilities, and that in the recession period the continuing availability of new long-term resources permits sizable reductions in current liabilities while businesses are maintaining relatively steady their ownership of current assets.

Features of current assets picture

As is well known, swings in inventory investment are a major feature of cyclical developments and such financing demands need no further review at this point, except to note that in the current period demand for increased inventories at the moment is no longer the large expansionary feature which it has been in the most recent quarterly periods. Corporations were adding more than $4 billion a year to their inventories in the past two years, though at varying rates within these years.

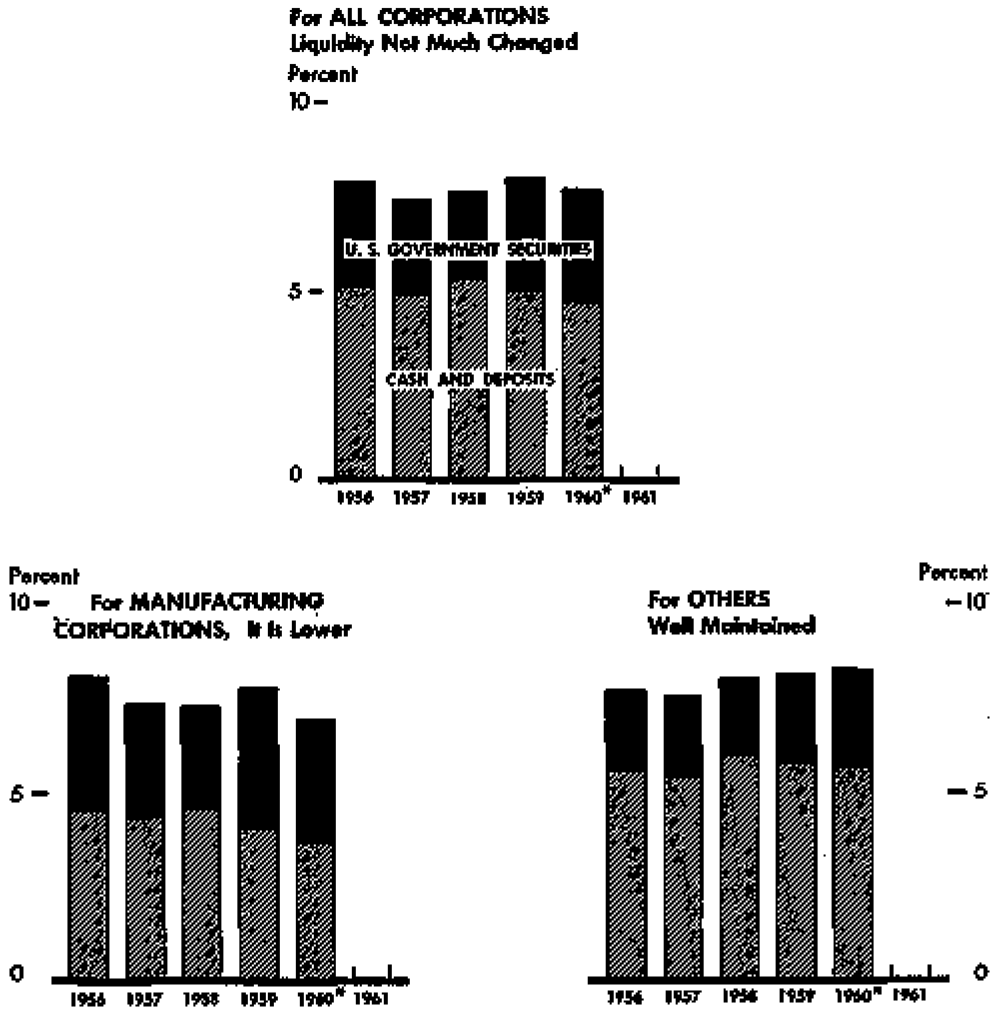
Among other working capital needs, expansion of trade credit by corporations has been of growing importance in recent years. In this context it is perhaps most useful to eliminate intercorporate transactions which for the creditor requires financing but for the debtor corporation reflect a source of available credit. For corporations as an aggregate, only the net expansion of receivables over payables reflects a corporate financing requirement and a source of funds for noncorporate customers.

There are two principal groups of customers seeking temporary financing from the corporations—consumers and business. The net extension of corporate credit to these customers for the recent period, as shown in the accompanying table, has been substantial in each instance. Consumer financing was definitely responsive to cyclical influences in the 1950's, expanding rather sharply in recoveries, and leveling off in the recession period. In the year ended last June, such financing came to $2½ billion which was the highest net credit extension of this kind in the postwar period.

With the tendency to higher costs of borrowed funds in the 1958–60 period, corporate management has made an intensive drive to keep non-interest bearing cash reserves at a minimum. Thus, as liquidity rose with the general level of activity, corporations tended to invest in short-term Government securities rather than to accumulate money assets. In the 2 years from mid-1958

CORPORATE LIQUID ASSET HOLDINGS

As a Ratio to Corporate Sales



Note.—Cash and U.S. Govt. security holdings on June 30 as a percent of annual sales
* Estimated

Data: SEC & OBE

U. S. Department of Commerce, Office of Business Economics 60-10-11

to mid-1960, cash resources were maintained stable at $34½ billion and holdings of U.S. securities increased from $15.3 billion to $21.7 billion.

Short-term financing

The recent pattern of short-term corporate financing has been affected, first and foremost, by the cyclical and other special aspects which have featured working capital needs, and secondly, by changes in the income tax laws.

As already indicated, the rapid expansion of current assets since the 1958 recession was through mid-1960 mirrored in a persistent demand for bank credit, featured in particular by manufacturers' requirements. This industry—and more particularly, durable goods producers—expended their short-term bank borrowing at a relatively steady pace until last midyear. With inventory needs shifting as indicated in the review of this subject elsewhere in this issue, such credit needs have no longer been pressing, and in the third quarter of the year it appears that manufacturers were reducing their outstanding bank debt.

Table 3.—Sources and Uses of Corporate Funds, Annual, 1956–59; Half Years, 1956–60 [1]

[Billions of dollars]

	1956	1957	1958	1959	1st half 1956	1st half 1957	1st half 1958	1st half 1959	1st half 1960	2d half 1956	2d half 1957	2d half 1958	2d half 1959
SOURCES, TOTAL	47.9	42.6	30.7	53.1	16.8	18.0	5.2	26.1	20.7	31.1	24.6	26.5	27.0
Internal sources, total	27.9	28.0	26.3	30.6	14.1	14.6	12.0	15.8	15.3	13.7	13.4	14.3	14.8
Retained profits [2]	10.6	8.9	6.1	9.1	5.6	5.2	2.1	5.2	4.0	4.9	3.7	4.1	3.9
Depreciation	17.3	19.1	20.3	21.6	8.5	9.4	9.9	10.6	11.3	8.8	9.7	10.3	10.9
External long-term sources, total	11.1	12.0	10.9	9.7	5.1	6.0	5.6	4.6	4.5	6.0	6.0	5.4	5.1
Stocks	3.2	3.5	3.6	3.7	1.2	2.2	1.8	2.1	1.6	2.0	1.3	1.8	1.6
Bonds	4.7	7.1	5.9	4.3	2.2	3.3	3.2	1.9	2.0	2.5	3.8	2.7	2.4
Other debt	3.2	1.4	1.4	1.7	1.7	.5	.6	.6	.9	1.5	.9	.8	1.1
Short-term sources, total	9.0	2.6	−6.4	12.7	−2.4	−2.6	−12.4	5.6	.9	11.4	5.2	6.0	7.1
Bank loans	2.2	.3	−2.4	2.1	2.4	1.6	−1.4	1.1	2.5	−.2	−1.3	−1.0	1.0
Trade payables	5.5	2.4	−1.5	6.3	.5	−.4	−5.0	2.1	−.9	5.0	2.8	3.5	4.2
Federal income tax liabilities	−1.7	−2.2	−2.4	2.4	−6.5	−5.0	−6.8	.5	−2.4	4.8	2.8	4.4	1.9
Other	3.0	2.1	−.1	1.0	1.2	1.2	−.3	1.0	1.7	1.8	.9	.1	(3)
USES, TOTAL	45.0	40.3	30.3	51.6	15.6	16.3	4.6	25.1	18.7	29.4	23.9	26.7	26.5
Increase in physical assets, total	37.5	34.8	23.1	33.0	18.2	17.9	10.3	17.5	18.6	19.3	16.9	12.8	15.5
Plant and equipment	29.9	32.7	26.4	27.7	13.6	15.6	13.0	12.8	14.6	16.3	17.1	13.4	14.9
Inventories (book value)	7.6	2.1	−3.3	5.3	4.6	2.3	−2.7	4.7	4.0	3.0	−.2	−.6	.6
Increase in financial assets, total	7.5	5.5	7.2	18.6	−2.6	−1.6	−5.6	7.6	.2	10.1	7.0	13.9	11.1
Receivables	8.8	4.5	2.8	10.6	3.2	2.1	−1.8	5.4	2.0	5.6	2.4	4.6	5.2
Consumer	1.4	.9	−.8	2.8	−.2	−.6	−1.6	.1	(3)	1.6	1.4	1.3	2.7
Other	7.4	3.6	3.6	7.8	3.4	2.7	−.2	5.3	2.0	4.0	1.0	3.4	2.5
Cash and U.S. Government securities	−4.3	−.3	3.5	3.8	−8.0	−4.2	−3.8	.2	−4.5	3.7	3.9	7.3	3.5
Cash (including deposits)	.3	.1	2.5	−.1	−2.2	−2.0	−.4	−1.6	−2.9	2.4	2.1	2.9	1.4
U.S. Government securities	−4.6	−.4	1.0	3.9	−5.8	−2.2	−3.4	1.8	−1.6	1.3	1.8	4.4	2.1
Other assets	3.0	1.3	1.0	4.2	2.2	.6	(3)	1.8	1.8	.8	.7	1.0	2.4
DISCREPANCY (uses less sources)	−2.9	−2.3	−.5	−1.5	−1.2	−1.7	−.6	−1.0	−2.0	−1.7	−.6	.2	−.6

1. Excludes banks and insurance companies.
2. Includes depletion.
3. Less than $50 million.

Source: U.S. Department of Commerce, Office of Business Economics, based on Securities and Exchange Commission, and other financial data.

Effect of tax law change

Since 1955 large corporations have been required to change gradually to a more pay-as-you-earn basis. As a result, through 1959 there was a more than usual drain on working capital. Now that the shift-over has been completed, tax payments in any year are more closely related to current period accruals.

The shift in payments has also served to even out the flow of tax payments from the extreme conditions prevailing earlier when the entire amount of tax due had to be paid in a half-year period. Currently the law stipulates four equal quarterly payments beginning in the third quarter of the tax year. Some seasonal influence still persists, however, because of difficulties in estimating taxes before the full year results are known.

Table 4.—Sources and Uses of Corporate Funds by Industry, Years Ended June 30, 1957–60

[Billions of dollars]

	Manufacturing and mining 1957	1958	1959	1960	Railroads 1957	1958	1959	1960	Transportation other than rail 1957	1958	1959	1960	Public utilities and communications 1957	1958	1959	1960
SOURCES, TOTAL	24.6	11.0	26.2	21.9	1.1	.1	.9	.8	1.5	1.4	1.8	2.0	6.6	8.7	7.9	8.2
Retained profits [1]	7.6	4.6	7.0	5.9	(2)	−.2	−.1	−.2	.1	−.1	−.1	−.1	.3	.2	.4	.4
Depreciation	9.2	9.9	10.5	11.0	1.0	.9	.9	1.0	1.0	1.1	1.2	1.2	2.7	2.9	3.1	3.3
External long-term sources [3]	4.4	2.0	3.1	1.5	.1	−.3	−.1	−.1	.2	.4	.6	.5	4.0	5.4	3.8	3.7
Short-term sources [4]	3.4	−5.4	5.6	3.6	.1	−.4	.2	.1	.2	(2)	.2	.4	.0	.2	.0	.8
USES, TOTAL	22.4	9.2	25.7	21.3	1.1	.5	1.2	1.0	1.6	1.7	2.0	2.2	6.9	9.7	8.9	8.8
Plant and equipment	17.0	15.0	11.9	14.7	1.3	1.1	.7	1.1	1.5	1.5	1.4	1.9	6.4	9.1	8.5	8.7
Inventories (book value)	3.6	−3.8	2.6	4.8	(2)	−.1	(2)	(2)	(2)	(2)	(2)	.1	.1	(2)	(2)	(2)
Receivables and miscellaneous assets	3.4	−.9	6.3	3.7	(2)	−.1	(2)	(2)	.1	.2	.3	.2	.3	.3	.4	.2
Cash and U.S. Government securities	−1.6	−1.1	4.9	−1.9	−.2	−.4	.5	−.1	(2)	(2)	.3	(2)	.1	.3	(2)	−.1
DISCREPANCY (uses less sources)	−2.2	−1.8	−.5	−.6	(2)	.4	.3	.2	.1	.3	.2	.2	.4	1.0	1.0	.6

1. Includes depletion.
2. Less than $50 million.
3. Includes stocks, bonded debt, long-term bank loans, mortgages and other long-term debt.
4. Includes short-term bank loans, trade payables, Federal income tax liabilities, and miscellaneous liabilities.

Source: U.S. Department of Commerce, Office of Business Economics, based on Securities and Exchange Commission, and other financial data.